State of California
Department of Real Estate

TIME-SHARE MANUAL

Guidelines for Processing Time-Share Applications for Public Report

Subdivisions, Technical Section

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TIME-SHARE MANUAL
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THE CALIFORNIA REGULATORY PROCESS FOR TIME-SHARE OFFERINGS

Types of Subdivisions Regulated by the DRE

The California Department of Real Estate (DRE) regulates the initial setup and sale of all California subdivisions including condominiums, planned developments, stock cooperatives, and time-share offerings, including out-of-state time-share subdivisions, that are offered for sale in California.

Definitions (Use and Estate) Time-Share Subdivisions

Definitions of the different types of time-share subdivisions are found in the Real Estate Law as follows:

- Subdivision (general) – Business and Professions Code Section 11000
- Time-share project defined – Business and Professions Code Section 11003.5(a)
- Time-share estate project defined – Business and Professions Code Section 11003.5(b)
- Time-share use project defined – Business and Professions Code Section 11003.5(c)
- Time-share subdivision defined – Business and Professions Code Section 11004.5(e)

Department Responsibility

The Subdivided Lands Act charges the Real Estate Commissioner with the responsibility of assuring that purchasers of lots, units or time-shares in any of the above listed developments receive everything for which they bargained. A Subdivision Final Public Report must be issued and a copy given to each purchaser prior to the execution of a sales contract for a sale of a lot, unit or time-share. A copy of this report must also be given to any member of the public who requests one. The Subdivision Public Report, or in the case of an out-of-state offering, the Permit, is issued only after the developers comply with the provisions of all the subdivision laws and regulations. Virtually all time-share projects, whether located inside or outside the state are considered to be subdivisions.

Exemption From Corporation Code 25100(f) Defined

Because the sale of the time-shares in these projects is regulated under the Subdivided Lands Law, their sale is exempt from qualification under Corporations Code 25100(f) of the California Corporate Securities Law of 1968, unless the offer is coupled with an investment contract, including such features as a rental pool. This means that in practically all time-share sales, the transactions can be handled by real estate licensees. No securities license is usually necessary. However, if investment contracts are being sold in connection with a time-share, a securities license may also be necessary. Subdividers and their marketers should check with the Corporations Commissioner for clarification.

History – Time-Share

The Subdivided Lands Act was amended effective January 1, 1981, to include time-share estates and time-share uses; however, the Department had jurisdiction prior to that date over time-share estates. In fact, the Department had issued Public Reports on 26 time-share projects before 1981. The first time-share Public Report was issued on ***The Brockway Springs of Tahoe Condominiums*** when the Public Report was amended on June 30, 1972, to accommodate 1/11 interests in the remaining condominiums.

Time-share use offerings in hotels, motels and apartment houses were exempt from our jurisdiction before January 1, 1981. After the law was changed to give the Department jurisdiction over these offerings, it was also modified to allow a "compliance grace period." This meant that if the previously exempt projects made timely filings with the Department of Real Estate for Public Reports, they could continue their sales programs until Final Public Reports could be issued. This also mandated that the Department had to allow sales to continue unless we were able to prove that continued sales would result in a dangerous situation for the time-share purchasers. There were 26 "compliance grace period"

applications. Some obtained Public Reports and others have voluntarily suspended sales, have abandoned their filings or have had their application denied by the Department.

The regulatory process for approving Public Reports for time-share projects is complex, cumbersome and expensive. Only the most highly trained Subdivisions Deputies are assigned to handle them. The legal fees for setting up the Trust, the Declaration and the Bylaws can be substantial.

THE ASSOCIATION AND THE MANAGEMENT

Association Responsibilities

It is the responsibility of the owners' association to govern the project and to see that a high quality of maintenance continues. The provisions for governing and maintaining a project are included in the management documents if the association will only take advantage of all of these provisions.

Time-Share Management

Since owners are all absent from the premises, except for one or two weeks per year, it is imperative that the project have not only a working board of directors but also highly professional, dedicated and honest on-site management. It is important that the board of directors of the association, as well as members, monitor the day-to-day operation of the club or condominium or whatever facility constitutes the time-share project.

ADVERTISING

California law does not require that subdivision advertising material be approved prior to use, whether the project is in or out-of-state; however, proposed advertising may be filed for review and approval by the DRE pursuant to Section 11022 of the Business and Professions Code.

Voluntary advertising submissions must be filed in duplicate and be accompanied by a fee, currently $75. The Commissioner prescribes the amount of the fee by Regulation. The DRE has fifteen calendar days from receipt of the material to communicate disapproval of proposed advertising.

Refer also to Sections 10140, 10177(c), 11022, 17500, 17537, 17537.1 and 17539.1 of the Business and Professions Code and to Regulation 2799.1. Deputies who review advertising should have copies of ***Subdivision Advertising Guidelines*** (RE 631) since it contains most of the specific requirements that must be adhered to by advertisers.

Advertising must be filed directly by the sponsor or any other party who the sponsor has authorized in writing to submit advertising on its behalf. If advertising is submitted with the application for a Public Report or Permit, the reviewing Deputy should inform the sponsor that the advertising will not be reviewed until after the Public Report or Permit is issued and then only if there is a separate advertising filing made by the sponsor with the required advertising filing fee. The only exception to this is when the sponsor is submitting advertising in compliance with Regulation 2810(d), for a single-site time-share project with a mandatory reservation system.

Expensive advertising and merchandise "give away" programs are used to attract prospects to the projects. Many of these programs originate from a nationwide advertising firm. Frequently, these firms attempt to deal directly with the DRE regarding advertising programs. In no case should Deputies deal directly with advertisers unless the sponsor has filed an application and fee to have an advertising plan for a specific project reviewed and there is evidence that the subdivider has provided, in writing, express authorization for an advertiser to submit advertising for a specific project. (No advertising should be used prior to issuance of a Public Report/Permit.)

Violations of advertising regulations are submitted to DRE Enforcement along with comments from the Advertising Review Deputies. Desist and Refrain Orders may be issued to control misleading advertising.

JURISDICTIONAL LIMITS

There are certain provisions the Deputy should apply when determining whether an offering qualifies as a time-share subdivision subject to the Public Report/Permit requirements of Section 11018.2, if the application of provisions contained in Section 11004.5(e) are not readily apparent.

General Principles and Applications

Single Declaration and/or Reciprocal Use-Rights
A time-share program consists of multiple dwelling units which are subject to a single declaration of time-share restrictions or there are reciprocal use rights between the dwelling units, and 12 or more time-share intervals are being offered for sale. The sponsor of the offering ***must*** obtain a Public Report/Permit since the characteristics of this offering fit the definition of a time-share subdivision found in Subsection 11004.5(e) of the Business and Professions Code.

Examples of Single Declaration and/or Reciprocal Use-Rights
Reciprocal Easements
An owner of 2 houses located on separate parcels wants to offer 11 time-share intervals in each house. Reciprocal easements will be created so that time-share owners will have the right to occupy either of the houses. This would probably constitute a 22-interest time-share subdivision. In any event, in a case in which there are reciprocal easements, the Deputy should ascertain the nature of the easements before making any decisions concerning integration. Each offering should be judged on its own merits.

Single Declaration vs. Separate Declaration
If the 2 houses described above were covered by one declaration, the offering would consist of 22 time-share interests subject to Public Report/Permit requirements.

If each house is subject to a separate declaration and there are no reciprocal use-rights, but are located in the same subdivision, we would still consider this one project of 22 time-share interests and subject to DRE jurisdiction.

Time-Share Variations – Exchange Program
An individual proposes to sell 11 time-share intervals in each of two units. The purchasers receive reciprocal rights to use both units through a sponsor-developed exchange program. Management is through either one or two associations.

This is either two 11-interest subdivisions or one 22-interest subdivision. A single association or reciprocal rights to use, provided for in the governing instruments, would create a 22-interest subdivision. If both units are in the same subdivision, and the offering is made after January 1, 1983, this would be a 22-interest subdivision subject to DRE jurisdiction. Again, the Deputy **must** obtain more information about the exchange program before making an evaluation.

Public Report Requirements for a Time-Share Owners' Association
If a time-share owners' association acquires 12 or more interests from the original recipient of a Public Report or from someone who succeeded to the interest of the original recipient of a public report, the association needs a Public Report before it may offer time-share interests for sale. See Regulation Section 2801.5 which defines "subdivider."

An owners' association may acquire inventory from individual time-share owners through foreclosure or in lieu of foreclosure. As long as that inventory does not include 12 or more interests that someone acquired from the original recipient of a Public Report or its successor-in-interest, the association would not need a Public Report before marketing those interests. There may be occasions when an association has inventory acquired more than 12 interests from the original recipient of the Public Report or its successor-in-interest and other inventory from individuals. The association would then need a Public Report only for those interests it acquired from the original recipient of the Public Report or its successor-in-interest.

An owners' association would be required to apply for a Public Report if a Public Report for the time-share project was never issued and the project consists of 12 or more interests. This may occur with respect to an out-of-state project in which the association is the owner of 12 or more interests and intends to make sales in California. In this case the source of the interests the association acquired is of no importance. A Public Report is required in any event.

Time-Share in Different Locations
Revised Code Section 11004.5(e)(2), effective January 1, 1983, defines a time-share subdivision as any combination of 12 or more time-share interests in 2 or more time-share projects in the same subdivision. There are other situations under which units in different locations would be subject to a Public Report/Permit.

Example of Time-Share In Different Locations
If there are 2 condominium units owned by the same developer, each in different cities and 11 intervals offered in each unit, we would consider the offering subject to Section 11004.5(e) if both units are covered by one declaration or there are reciprocal use rights between the units. Otherwise, a Public Report/Permit is not required.

However, if both units are in the same condominium project, and there are no reciprocal use rights and each has a separate time-share declaration, the offering ***would*** require a Public Report/Permit.

Divided Intervals
The ability of the time-share interest owner to divide his interval because of the nature of the original offering can not be taken into consideration when determining whether the sponsor must qualify the offering for a Public Report.

Example of Divided Intervals
The sponsor owns a house and proposes to convey an undivided 1/11 interest to each of 11 buyers with the right to use a specified 30-days each year.

The governing instruments provide that the 30-day use-periods are not contiguous but are divided into a one-week period in each of 4 seasons.

The fact that each of the 11 owners may divide the 30-day periods into 4 weeks and sell each week is no basis for claiming that the sponsor must qualify for a Public Report.

However, if the division and sale of individual weeks would benefit the sponsor, the sponsor would probably be required to obtain a Public Report/Permit.

APPLICATION FORMS

In-State and Out-of-State Index

Real Estate Form 698 – Application Packet Information for In-State Time-Share Public Report and Out-of-State Permit (RE 698)

This form lists most Department of Real Estate forms that may be needed in filing for a Time-Share In-State Public Report or Out-of-State Permit.

Real Estate Form 668 Part I and Part II – Applicant Instructions and Index/Quantitative Deficiency Notice for Time-Share Public Report or Permit (RE 668 Part I and II)

The instructions contained in this form are to be followed by all applicants, with some instructions specific only to projects in California, some specific for out-of-state projects, and some applicable to both in-state and out-of-state projects.

Real Estate Form 668A – Questionnaire and Application for a Time-Share Project Public Report or Permit (RE 668A)

This questionnaire is to be completed and submitted by all applicants, both in-state and out-of-state.

If the offering involves a time-share project in which dwelling units exist in more than one location, the applicant must complete one application for each location.

Real Estate Form 635C – Questionnaire and Application for an Amended/Renewed Public Report or Permit for a Time-Share Project (RE 635C)

Multiple Locations – In-State/Out-of-State

In the case of multiple locations and units located both inside and outside of California, the filing will be treated as an out-of-state subdivision. Thus, those requirements on this form that normally apply only to out-of-state subdivisions will also apply to any unit located in the State of California.

MASTER TIME-SHARE FILING

Qualifying

To take advantage of the master filing procedure, it ***must*** be requested by the sponsor or his representative at the time he makes the original filing on the first increment. He should, at that time, submit the master documents that would apply to all subsequent increments of the project. The sponsor must specify which documents will apply to all increments. Increment may be defined as lot, tract, or subdivision of land. Master filings for time-share projects that will have two or more increments to be filed separately will be acceptable.

[In some cases, the time-share project may be part of another type of a common interest project (usually a condominium). In this situation, a separate filing must be made for that common interest project.] The master filing for the time-share project must be different than that for the common interest subdivision.

Required Documents

In most cases, the following documents would be suitable for a master file:

(1) Overall plan for the project development.

(2) Master Declaration of Dedication.

(3) Bylaws and Articles of Incorporation.

(4) Management Agreement.

(5) Rules and Regulations.

(6) Conveyancing and sales documents (deeds, notes, leases, options, contracts of sale, deposit receipts, bill of sale, etc.).

Note: Pro forma escrow instructions should not be considered a document suitable for a master file.

(7) Master Geographic letter from local agency.

(8) Trust Agreements.

(9) Financial arrangements for off-site improvements.

(10) Department of Corporations interpretive opinion.

(11) Copy of letter giving notice of proposed dedication of dwelling units to a time-share project to local agency and, where applicable, to Coastal Commission.

(12) Copy of letter from local tax assessor describing how dwelling units will be assessed for real property tax purposes.

(13) Copy of Environmental Impact Report or Negative Declaration.

(14) Copies of contracts and promotional and informational material pertaining to exchange program.

(15) Flood and drainage reports.

(16) Evidence of establishment of community services district or other district to supply water or other services to overall development.

(17) Record of district formation or bond proceedings.

(18) Subsidy Agreement.

This is not intended to be a complete list of possible documents that may be required.

There are cases when some of these documents may be applied to all increments. This should be determined at the initial filing and the sponsor should be informed so misunderstandings are averted.

SUBDIVISION MAP ACT

The creation of undivided interests in a single parcel of real estate does not constitute a subdivision under the Subdivision Map Act. However, the Subdivided Lands Act is applicable. Because of this, usually no new map is required by local government regardless of the type (use or estate) of time-share project.

If the sponsor is creating an underlying project in California, such as a standard lot subdivision or a common interest development as defined in the Davis-Stirling Common Interest Development Act, simultaneously with the time-share project, he would be required to comply with the Subdivision Map Act for this underlying subdivision.

If the time-share project is out-of-state, the subdivision may be subject to local jurisdictional requirements comparable to California's Map Act. The reviewing Deputy should ask for a copy of the recorded map and all applicable maps enumerated below. The maps should be reviewed carefully because different states and localities often have standards for map approvals that are much different from that of California. If the sponsor states that there is no subdivision map requirement for that jurisdiction the Deputy should request authoritative support for such an assertion from the appropriate government agency, an attorney's opinion letter or copy of the subdivision laws for that jurisdiction.

The Deputy should ask for a copy of the situs state's subdivision laws in any event as it may become important in evaluating compliance with California regulatory standards.

Maps to be Submitted

Recorded Map
A copy of the map referenced in the legal description, as shown on the Title Report, must be submitted prior to issuance of the Public Report.

Condominium Plan
If a condominium project is being converted to time-share use, or a condominium project is simultaneously being created, a copy of the recorded condominium plan must be submitted prior to issuance of a Public Report.

Plot Plan
A large scale, legible plot plan (site plan) showing all improvements, including location of recreational amenities and boundaries of future phases, if any. In certain cases, the map itself may serve as a plot plan.

Floor Plan
This is applicable to hotels or motels and should reflect the dimensions for units. Include room number and other pertinent information which appropriately describe the unit layout.

Vicinity Map
The sponsor should always submit a large scale, legible vicinity map showing the location of approaches to the subdivision and identifying "landmarks" to help locate the subdivision.

MAINTENANCE AND ASSESSMENT BOND

Reference: Security for Sponsor's Obligations as an Owner of Interests. Regulation 2812.3.

Bond, Letter of Credit, or Cash Deposit

The security should be in an amount equal to 50% of the anticipated cost of operation and maintenance of the project, including reserves, for one-year (hereinafter called budget).

First Phase of Multi-Phase or Single Phase Project

The amount should be 50% of the budget for that phase. The security may be released when 80% of the interests have closed escrow if the sponsor is not then delinquent.

Subsequent Phase of a Multi-Phase Development

Units Sold and –

80% of the interests in the prior phase have been sold and the security has been released:

In this case, the amount of the security to be posted with escrow holder prior to issuance of the Phase II Amended Public Report is 50% of the Phase II budget. The Phase II budget equals (interests in Phase II) x (assessment/interests against all interests in Phases I and II). The security may be released when 80% of the interests in Phases I and II have closed escrow and the sponsor is not then delinquent.

Units Unsold and –

80% of the interests in the prior phase have ***not*** been sold and the security has ***not*** been released:

In this case, the amount of additional security to be posted prior to issuance of the Phase II Amended Public Report is 50% of the Phase I and Phase II budget (or built-out if only two phases) less that amount already posted under Regulation 2812.3 with escrow holder. The security may be released when 80% of the total interests in Phases I and II have been sold.

Alternative

The sponsor may post separate securities for each phase. In each phase, release of the security could occur upon the sale of 80% of the interests in the phase for which the security was posted.

Regulation 2812.3 Requirement for Amended Public Report

If a there is a new sponsor applying for a Public Report after sales have been closed by a previous sponsor, the new sponsor need not make financial assurances under Regulation 2812.3 if 80% of the total number of time-share interests dedicated to the time-share project have been sold. However, if there have been fewer than 80% of the time-share interests sold, the sponsor must post a bond, letter of credit, etc. in an amount based on the number of interests to be offered for sale by the successor sponsor and excluding the interests sold by the previous sponsor.

Frequently, a sponsor who had been selling under a Public Report and applies for an amended Public Report, requests that the amount of the bond, letter of credit, etc. be based only on the number of unsold interests left. For example, if the project consists of 1,000 time-share interests and 500 had been sold as of the date of the amendment application, the sponsor often will request the bond amount be based only on the 500 unsold interests. That request should be denied. Until 80% of the all the time-share interests in the project have been sold, the bond should be based on all of the time-share interests. In the example given, the bond amount should be based on all 1,000 interests.

Form of Security

Bond
The sponsor should complete RE 643N, the surety bond form.

Letter of Credit
The sponsor should use RE 643O as the format for the Letter of Credit under Regulation 2812.3. The Letter of Credit should be irrevocable and unconditional, issued by an authorized representative of a recognized lending institution. If the sponsor does not use RE 643O, it should be reviewed by the Deputy and, if necessary, by Legal counsel for sufficiency.

Cash
The Deputy should obtain from the escrow holder a letter or a receipt showing that cash in the proper sum has been deposited into a specific numbered escrow account.

Set Aside Letter
If the sponsor intends to use a set aside letter to secure its 2812.3 obligations, the set aside agreement should be reviewed for sufficiency and should be given to the Managing Deputy Commissioner III for approval or denial before acceptance.

Escrow Instructions
Insist on use of form RE 643C. The sponsor may submit alternative instructions, but they should be reviewed to determine they include the important aspects of the ***Escrow Instructions and Security Agreement*** portions of RE 643C. If the reviewing Deputy is unsure whether the alternative instructions are adequate, a request may be made through the Managing Deputy Commissioner III for a Legal review.

Difference Between 2792.9 and 2812.3
The major difference between Regulation 2812.3 and Regulation 2792.9 is that 2812.3 does not provide for issuance of a Public Report upon receipt of escrow instructions providing that no escrows may close until 80% of all escrows close simultaneously, as does 2792.9(a)(1). However, the DRE would probably accept an 80% presale as an alternative to the bond, although whether the DRE would accept such an alternative would be an issue to be studied on an individual case basis.

ISSUANCE OF PRELIMINARY PUBLIC REPORTS
Preliminary Public Reports or Permits will not be issued for out-of state time-share projects.

Blanket Encumbrance – Presale
The existence of a blanket encumbrance requiring conveyance of the project to a trustee pursuant to Regulation 2812.2 trust agreement, requires the establishment of a presale number.

This presale number may be reduced to the question "How many sales are necessary to yield enough sales contracts/or promissory notes to total 100% of the sum of the principal balances of all blanket encumbrances encumbering the project less any cash held by trustee available at any time to reduce these principal balances?"

Example of Blanket Encumbrance – Presale
For example, assume a 20-room hotel conversion estate project is encumbered by two deeds of trust, the unpaid principal balances of which are $800,000.00 and $200,000.00. Since the sponsor cannot

persuade the trust deed beneficiaries to partially reconvey undivided interests, title to the project has been conveyed to a trustee.

The only cash held by the trustee is the amount required pursuant to Regulation 2812.2(d)(2), for payment of three successive monthly installments on the loans. The loans are fully amortized and no sinking funds are to be created.

The sponsor proposes to take down payments of 25% and to carry back promissory notes of 75% of the purchase price. One week interests are to be sold for $8,000.00 each, yielding promissory notes of $6,000.00.

Since no sinking funds to retire balloon payment obligations exist, and since the three monthly installments must be retained for the duration of the trust and are not available to be applied to reduction of the $1,000,000.00 principal balance, the presale number must be ***at least*** $1,000,000.00 divided by $6000.00 or 167 sales. Because Regulation 2812.2(d)(1) requires the aggregate principal balance of all purchaser sales contracts/promissory notes to be at least 150% of the sum of the principal balances of all blanket encumbrances, the Deputy may set a higher presale after considering factors such as the estimated time it would take to reach the 150% figure required under the Regulation. In any event, if the 150% figure will not be reached at the close of the first escrow, the trust instrument must include a provision requiring the deposit into trust of one out of two of every sales contract/promissory note thereafter until the 150% requirement is met as required by Regulation 2812.2(d)(1)(A).

The escrow instructions should require that no escrows close until the required number of escrows to meet the presale, close concurrently ***and*** until escrow holder receives written notice from the trustee that trustee holds an express number of promissory notes as required.

Presale Review – DRE Attorney

Since the trust agreement will be reviewed by a staff attorney, the Deputy should consult with the attorney prior to notifying the sponsor of the presale number and the proper escrow instruction.

COMMON AREA – COMPLETION AND CONVEYANCE

A time-share offering is a common interest subdivision and includes elements not required in standard filings. These include the completion and conveyance of the common areas as required by Business and Professions Code Section 11018.5 and Regulation 2812.1. Reasonable arrangements regarding these two elements must be completed prior to issuance of a Final Public Report. Common area completion and conveyance are separate concepts which need not occur simultaneously and should be processed as distinct requirements by the Deputy. Common areas are either to be owned by the purchasers as tenants in common or in fee by a legal entity such as a homeowners' association or corporation or by a combination of the two ownership forms. The ownership of the common areas will have some effect upon the manner in which the principles of completion and conveyance are processed.

Improvements Completed Before Public Reports are Issued

If the applicant presents evidence that all improvements have been completed or will be completed before the Public Report is issued, we need only the assurance that improvements will be conveyed to purchasers or the homeowners' association lien-free. This can best be accomplished by insisting upon escrow instructions that prohibit the impound depository from releasing any purchaser's funds from the impound until the time-share interest has been conveyed lien-free to the purchaser.

Escrow Instructions Clause – Arrangements
Escrow instructions containing a clause substantially along the following lines should suffice for this purpose:

> "All funds deposited by the purchaser of a time-share interest shall be held in escrow until the project is completed and title free and clear of any blanket encumbrance has been conveyed to the purchaser."
>
> In addition to the above described conditions, escrow shall not close until:
>
> "The expiration of the statutory period for the recordation of all mechanic's lien claims following the recordation of a valid Notice of Completion as defined in Section 3093 of the Civil Code."

Mechanic Lien Endorsement – Title Policy
If the subdivider has provided that each purchaser of a time-share interest shall receive a policy of title insurance with an endorsement against any possible future liens, a purchaser's funds may be released from impound – without regard to the time for filing of mechanic's lien claims – when the subdivider is able to convey title to the time-share interest free and clear of any blanket encumbrance of record.

The above procedure constitutes compliance under Section 11018.5(a)(2)(B) either if all development and improvement work will be completed prior to issuance of the Final Public Report or prior to closing of individual sale escrows.

Completed Improvements in an Out-of-State Project

Often, out-of-state jurisdictions do not issue Notices of Completion or any comparable document. Sometimes, a Certificate of Occupancy is the only official document issued representing completion of improvements. Unless such a document is the basis for protection against mechanics liens similar to a California Notice of Completion, other suitable evidence will need to be provided. It may require the Deputy with the assistance of the Managing Deputy Commissioner III and Legal counsel to review applicable subdivision laws from the situs state.

Lacking Notices of Completion, evidence of completion may be had by Certificates of Occupancy and statements from licensed architects. Photographs are not to be construed as satisfactory evidence of completion although they may be considered as supporting the documentation mentioned above.

Improvements not Completed Before a Public Report is Issued

If all improvements comprising the residential-structure common areas as well as the improvements to the separate or outside common areas will not be completed prior to the issuance of a Public Report, the developer may elect to comply with Subsection (A), (B), (C), (D) or (E) of Section 11018.5(a)(2) of the Business and Professions Code.

Demonstration of Viable Intent
The possibility of his electing (C) is remote. Regardless of which alternative the sponsor selects to comply with Section 11018.5(a)(2), he must demonstrate a "viable intent" to complete the development according to his plan under Section 11018.5(a)(1). "Viable intent" can be demonstrated by:

(1) Recognized lender's commitment to finance the entire construction work, or

(2) Evidence that the sponsor has his own funds for completion of the development work and has completed plans and specifications for construction, entered into construction contracts, posted bonds for off-site improvement work, etc.

Compliance With Section 11018.5(a)(2)(A)
If the sponsor elects (A), the bond or other financial arrangement must be in an amount sufficient to cover the completion of the residential-structure common area and the outside common areas within the subdivision for which the Public Report is to be issued.

Compliance With Section 11018.5(a)(2)(B)
If the sponsor elects to assure completion through compliance with (B), appropriate instructions to the impound depository shall be required. See the ***Escrow Instructions*** section of this manual for the appropriate escrow instruction language. That language may not be functional for some out-of-state projects, so alternative language will need to be evaluated for purposes of compliance with the statute.

Owners' Association or Trustee

In some cases, the sponsor may be able to convey the common area and facilities to the owners' association or, when required, a trustee, free of any blanket encumbrances prior to the issuance of the Public Report. When title to common areas and facilities is held by an owners' association or trustee, no problems are encountered as the number of owners of time-share interests increases or decreases. This consideration is particularly important with respect to the phased development of time-share subdivisions.

In these cases, care should be taken to eliminate the possibility that mechanic's lien claims will be filed against common areas after conveyance to the owners' association or trustee. This can be accomplished by:

(1) delaying issuance of the Public Report until expiration of the statutory period for filing of lien claims after the recordation of a Notice of Completion (60-days); or

(2) by the issuance of a policy of title insurance to the owners' association or trustee with an endorsement against unrecorded liens.

Where the homeowners' association is not incorporated, the conveyance may be made to its Board of Directors or trustees. The Deputy should make every effort to convince the developer to incorporate the homeowners' association even though incorporation of such an association is not required by law.

Purchasers as Tenants in Common

The sponsor may convey some or all of the common area to purchasers as tenants in common rather than to an owners' association. If the unit being time-shared is a condominium, it is necessary to convey at least some of the common area to purchasers as tenants in common, rather than to an owners' association, in order to qualify as a statutory condominium under the definition of Section 783 of the Civil Code.

Variations

There is nothing, however, that demands that common areas and facilities be conveyed to the purchasers as tenants in common or deeded to a homeowners' association. In fact, either method or a combination of methods may be used.

Examples:

(1) A condominium offering could provide:
- A separate interest in space;
- An undivided interest in common in the residential structure; and
- Conveyance of common areas and facilities other than the residential structure to the association.

(2) An apartment house or hotel conversion could provide:
- Undivided interests in common to the entire project.

Conveyance to Trustee

There may be a few instances where development in the common areas included in the offering, i.e., advertised from the beginning, is so extensive that the sponsor cannot reasonably be expected to complete the improvement work for several months or years after the issuance of the original Public Report. In these cases, the common areas and facilities should be bonded for lien-free completion and should be conveyed to a trustee approved by the Commissioner with the property held in trust for the benefit of the owners' association and the members thereof. The trust must be irrevocable and must provide for the conveyance of the common areas and facilities, free and clear of encumbrance, to the homeowners' association prior to or concurrent with the closing of the sale of 60% of the subdivision interests, or within a period not to exceed three years from the issuance of the Public Report, whichever occurs first in time. Until there is a conveyance of common areas and facilities to the owners' association, the subdivider bears the full responsibility for maintenance and operation of these facilities. Regulation 2812.1

Private Facilities Included in the Offering

Time-share offerings are often associated with hotel resorts with private recreational or other supporting facilities where the sponsor desires to make the recreational or other supporting facilities available to the time-share owners, but retain fee title to said facilities. This arrangement can be accomplished by conveyance of an easement or license to the time-share association. The Deputy should refer to the guidelines in Subdivision Manual Section 715 for private facilities. The use of these license or easement arrangement should be limited to supporting facilities. The Deputy should be cautious not to allow the sponsor to use any device to control the time-share project through the retention of ownership interest in the common area.

ASSESSMENTS PAYABLE BY OWNERS OF TIME-SHARE PROJECT INTERESTS – REGULATION 2813.4

Regulation 2813.4(d) requires that all interests in a time-share project for which a Public Report has been issued are interests subject to the payment of regular and special assessments. The Deputy should determine from the form RE 668A how many of the projected interests are to be offered for sale under authority of the Public Report as a preliminary step to reviewing the file documents.

All dwelling units in a subdivision that are to be dedicated to timesharing and to be covered by a Public Report must be subject to assessments upon the commencement date specified in the Restrictions pursuant to Regulation 2813.4(g).

Declaration of Dedication, Importance of

The Deputy should read the Restrictions (often called Declaration of Dedication, Declaration of CC&Rs, etc.) that relates to assessment obligations and procedures. Many form RE 668A applications state that the Public Report is to cover all of the potential interests in the resort, but the proposed Restrictions may

state that Declarant, for each time-share interest owned and each purchaser, for each such interest owned, covenant to pay assessments. It is crucial to locate in the Restrictions the definition of a time-share interest since usually only interests in some of dwelling units are designated as such. The remaining units are normally designated as "non-dedicated units" or simply as "units." The improper result is that the sponsor is only obligated by the document to pay assessments on unsold interests in time-share interest units and does not pay assessments on interests in units not dedicated to time-sharing.

A good method for avoiding this problem is to require the sponsor to covenant in the assessment article to pay assessments on "x" interests ("x" = the interests to be covered by the Public Report) less interests sold to purchasers.

Sponsor's Obligation to Pay Assessment to an Association

Sometimes the proposed project will consist of a combination of hotel/motel units and units dedicated to time-sharing. For various reasons, the developer may want to have the Public Report cover all the units. If the Public Report covers all dwelling units in the project, and that the sponsor pays assessments on all such interests, the association normally is required to manage all units in the project pursuant to another provision in the Restrictions. This duty belongs to the association even though only some rooms are available for reservation by purchasers (time-share units) while the remainder are not available. The Subdivisions Deputy and the Budget Review Deputy should review the Restrictions and proposed budget to assure the sponsor is obligated to pay to the association those costs uniquely allocable to the sponsor's rental to the public of non time-share units.

The agreement required by Regulation 2812.7 does not necessarily serve this purpose. This regulation contemplates the case where only a few of the rooms in a resort are dedicated or are to be dedicated to the time-share project, while the remaining rooms are not dedicated nor will they be dedicated. Differently, in the project type discussed above, all of the rooms are dedicated and are part of the time-share project, since all of the mixed time-share/commercial property is made subject to the Restrictions, including the Restriction assessment covenants.

Thus, a properly drawn subsidy agreement or a "vacant unit budget" more appropriately serves the purpose of the Department in its processing efforts than a Regulation 2812.7 agreement. These alternatives are discussed elsewhere in this policy manual.

Condominium Time-Share Conversion Project

Another common type of project is the condominium time-share conversion in which the entire condominium project, or merely a few units within the condominium project, comprise the time-share project.

The assessment structure of such a project usually falls into the following pattern:

Two associations are usually created. One is a routine condominium association, meeting the Department's usual regulatory requirements for condominium projects. This association is charged with the duty to manage and operate the condominium common areas. Assessments are levied by this association against each condominium unit to cover the costs of the management and operation. This may be called a "master association."

Time-Share Association

The time-share association can be viewed as a sub-association of the master condominium association. The time-share association is charged with the duty of managing and operating interiors of the condominium units included in the time-share project. The time-share project budget therefore includes

the assessments levied by the master condominium association, in addition to the extra costs unique to the time-share project.

Under the variation of this plan where the sponsor has dedicated only a few of the condominium units to the time-share project, there is no issue as to the requirement that the sponsor enter into a Regulation 2812.7 agreement with the association. The master condominium association will require that the sponsor or other owners of condominium units pay assessments covering their pro rata share of common area costs. The Deputy should assure that the master condominium association is, or has been formed and the condominium restriction containing a provision requiring the commencement of condominium assessments, not upon the first sale of a unit but instead upon the first sale of a time-share interest in a unit, is recorded.

Other Important Considerations in Analyzing the Assessment Structure of a Project

Regulation 2813.4(e)
An error sometimes found in proposed Restrictions is that the governing body is permitted to increase regular assessments (for costs other than real property tax increases) by a vote of the majority of the total voting power of the association. The Deputy should always require compliance with this Regulation and Regulation 2813.1(c), and require that no such increase may be authorized without a vote or written assent of a majority of the non-sponsor members. Note that Regulation 2813.4(e) takes precedence over the general voting requirements of Regulation 2813.1. Specifically, these assessment increases must be approved by a majority of all non-sponsor members of the association and not merely by a majority of those non-sponsor members present at a meeting at which a quorum is present. [See Regulation 2813(e)(1) for definition of "quorum."]

Regulation 2813.4(f)
The foregoing discussion of the mechanics of approval of regular assessments also applies to approval of special assessments. Note that the third exception to the general rule [Regulation 2813.4(f)(3)] sets no limit on special assessments imposed on a member to reimburse the association for costs incurred in bringing the member into compliance with the Restrictions or the rules and regulations adopted under authority of the Restrictions. This exception should be considered in combination with Regulation 2813.7(c). The Restrictions should limit the association's remedies against a member who has been specially assessed for disciplinary purposes to an action for damages. The association should not have the power to levy a lien and foreclose upon the disciplined member for nonpayment of such special charges.

Regulation 2813.4(g)
Occasionally, a sponsor will propose that assessments commence prior to close of the first escrow.

The usual reason given is that the sponsor wishes to afford to its contract vendees the right to occupy a unit prior to close of escrow. The Deputy should not permit assessments to commence prior to close of escrow. Occupancy prior to close of escrow should be allowed only pursuant to a pre-closing rental agreement. This rental agreement should be a separate agreement from the purchase agreement. However, the sponsor may offer a buyer the option of paying assessment prior to close of escrow if the buyer is given an absolute right to occupy a unit during the preclosing period. The buyer-seller escrow instructions must be studied carefully to determine that provisions are properly included to give buyers these occupancy rights and to provide that the assessment payment is properly escrowed in a separate account payable to the association if the escrow closes.

BUDGET REVIEW

The following are five categories that, in part, cover areas commonly reviewed by the Budget Review Unit (BRU).

Category I: "Scope of the Offering"

The RE 668A or RE 635C is reviewed to determine the following: whether the project is a single-site or multi-site, in-state or out-of-state (country), units covered, type of units, intervals or points, club concept, use versus fee, number of interests covered, mixed use, inventory, existing association, completion arrangements, third-party contractual obligations, subsidy arrangement, and management obligation. Finally, depending on whether it exists or is to be built, whether utilities are available or to be charged to the association.

Category II: "Site Inspection"

Ordinarily, if it is an in-state project, an on-site inspection is scheduled. The reviewer determines when and how the inspection is done. The inspection could be done before or after an in-house desk review is completed; however, in either case, the initial review should incorporate the on-site inspection findings.

An on-site inspection is performed in the same manner as a common interest subdivision, with the exception that the unit interiors are inspected, as well as shared use facilities. Particular attention is paid to projects that have a mixed use because of the potential of over burdening the association through cost sharing. For example, a converted hotel with dedicated units, when inspected, may indicate that hotel usage far exceeds the proportionate costs placed on the association and contractual obligation arising from the shared use favors the commercial area, as opposed to the association.

Category III: "Budget Analysis"

The initial budget review follows the same procedure as a regular common interest project (RE 623). However, because the association's obligation extends into the interior of the units, particular attention is placed on the project's inventory (i.e. furnishing contracts, inventory-per-unit, interior construction, etc.). Further, shared use is reviewed (e.g. dedicated units versus others) and its contractual obligations. Also, many projects are multi-tiered and may involve three or more associations maintaining/sharing costs.

An existing project requires additional review procedures, although similar to all common interest reviews. For example, a financial review is conducted, which includes the association's financial status, adequacy of the reserves, and inventory (points or interests).

Under either situation, the proposed budget or the adopted budget is reviewed "item-by-item" to ensure that the charges are reasonable and verified by actual contractual obligations (or proposed contracts). In addition, the contracts are reviewed to ensure that the provisions that impact the association are reasonable, not subject to the sponsor's exclusive control, and in compliance with the appropriate regulations.

Category IV: "Contractual Obligation with the Declarations"

A review of any contractual obligation (e.g. management contract, deficit subsidy agreement, shared costs, lease arrangement, telephone agreements, reservation agreements, etc.) usually is done in tandem with the budget (RE 623) review. In addition, the Declaration sections that cover the association's obligations and the sponsor's obligations are reviewed to ensure that budget concerns are adequately addressed. This would include rental provisions with association reimbursements, timeframe for rental use, and compliance with the appropriate regulations.

Category V: "Security Arrangements"

There would be several areas that may require some form of financial security arrangement, all of which are reviewed by the Budget Review Unit. For example, completion arrangements (may require a site inspection); deficit subsidy agreement (done with the budget review); cash-down subsidy arrangement (done with the budgets); shared cost agreement (done with the budget); fiduciary obligations and any other type of agreement that the sponsor promises to perform.

Recap and Problem Watch List

In general, due to the nature of a time-share project (i.e. highly technical, extremely numbers orientated, and the fact that the sponsor contracts to manage), it usually requires a case-by-case analysis. For example, request for 52 weeks sales versus 51 weeks, points conversion and allocation of assessments-to-points, etc. are additional areas of concern. Granted, as indicated above, the approach and procedure are not unlike a common interest subdivision; however, it is the "bundle of obligations" that may impact the association that a reviewer should be most concerned with when reviewing a time-share project.

The following is a watch list of violations and/or non-compliance issues relative to a time-share project of which the Budget Review Unit should be aware:

(1) Designating units as "live-in quarters" without implementing cost sharing agreement.

(2) Failure to provide financial accountability pursuant to Civil Code Section 1365.

(3) Failure to conduct foreclosure sales pursuant to the Declarations (notice and open to the public).

(4) Failure to provide reimbursement to the association pursuant to the foreclosure sale (delinquent assessments and costs).

(5) Failure to provide the defaulted interest's owner with the balance of the foreclosure sales proceeds (above and beyond association amounts).

(6) Failure to provide complete financials pursuant to Civil Code Section 1365.5 (expenditure, income, year-to-date and profit and loss statements).

(7) Failure to maintain financials records pursuant to the management agreement and the Declarations.

(8) Submitted inaccurate DRE forms (failing to notify of changes).

(9) Securing unauthorized association expenditures contrary to the Declarations (i.e. car lease, maintenance, fees).

(10) Payments to third-party service providers without appropriate recordation or contracts (maid and maintenance service).

(11) Charging the association with personal costs (insurance and property tax for adjoining property).

(12) Assumption of association foreclosed interests without the DRE's review of the contract.

(13) Revising DRE-reviewed documents and agreements without notice and subsequent review by the DRE.

(14) Expenditure of association reserve funds for non-reserve items.

(15) Expenditure of association funds to enhance the sponsor's interests (maid's unit, golf membership and camping club).

(16) Inadequate records of association meetings and voting irregularities (proxy person not in attendance).

(17) Failure to establish association operating and reserve accounts pursuant to Civil Code Section 1365.

(18) Failure to secure fiduciary bonds in compliance with DRE Regulations and the B&P Code.

(19) Commingled association funds with personal funds.

(20) Failure to establish contractual obligations with third-parties pursuant to the Declarations and the Regulations (car lease, soda machine, washer and dryer).

(21) Receipt of management fees in excess of contractual limitations (10% minus fee).

(22) Charging the association for services that were not provided (accounting, audits).

VACANT UNIT BUDGETS

By analogy to the "vacant lot" budgets permitted under Regulation 2792.16(c) for other types of common interest subdivisions, as a matter of policy, it is permissible for the time-share Restrictions to exempt the sponsor of a time-share project from the payment of that portion of any assessment which is for the purpose of defraying expenses and reserves directly attributable to the existence and use of units which are part of the project (units subject to the time-share Restrictions) but not built, or if built, not renovated or otherwise subject to occupancy.

Desk Clerk Expense

The budgeted management expense may include the services of a desk clerk, who has the duty to check in and out time-share owners. Given that the non-completed or non-renovated units are not subject to occupancy, the desk clerk's salary should be allocable for payment solely to time-share purchasers, and not to the sponsor. If the sponsor is not prohibited from renting non-completed or non-renovated units, the sponsor should not be exempt from sharing in the cost of the desk clerk's salary. If the presale number is set so that there are enough non-sponsor owners to support the desk clerk's salary without contribution by the sponsor, then there is no reason to limit the time period during which the sponsor is exempt from contribution to the desk clerk's salary.

Sponsor Allocated Expense

Some items of expense are more reasonably allocated to the sponsor for payment. For example, if the sponsor's renovation or building program causes the common areas to require more frequent recurring maintenance and clean up, the vacant unit budget should allocate the maintenance person's salary disproportionately, with the sponsor paying more of this expense per interest owned than does a purchaser.

Other items of fixed expenses, such as real property taxes, reasonably would be shared equally by the sponsor and purchaser per interest.

The final result of summarizing all such expenses as allocable to purchasers or the sponsor or both will probably be a lesser cost per interest owned to the sponsor than to the purchaser. Since the sponsor will realize that these costs accurately reflect its true carrying costs of the units if they were not part of the time-share project, it will be more likely to include all of the contemplated units in the project from the beginning. The temptation to phase will be reduced, thus avoiding mechanic's lien risks inherent in phasing a one-lot project undergoing construction or renovation; and the association will obtain more control over the project and will be better capitalized.

Vacant Unit Budget

A "vacant unit budget" (V.U.B.) is a suitable alternative to the subsidization program discussed under ***Subsidization*** of this manual, in that, the cost elements and allocations are initially known to the association and the sponsor in the case of the V.U.B. due to prior DRE review; whereas, in the case of a subsidy program, the association initially controlled by the sponsor determines how much the sponsor is to pay on a monthly basis without regard to the potential that the sponsor is unreasonably paying costs allocable to the association or that, more importantly, the association is paying costs more reasonably payable by the sponsor. Additionally, the proper bond amount under Regulation 2812.3 could be ascertained and the "subsidy" fiction, together with a Regulation 2812.4 bond requirement, could be abandoned, along with the cost of the 2812.4 bond.

Basic organization of a vacant unit budget could be as follows:

	#1 Renovated Units Subject to Reservation by Purchaser	%	#2 Non-Renovated Units Not Subject to Public Rental	%	#3 Non-Renovated Units Subject to Public Rental	%
100 – Fixed Costs	_____	___	_____ (Breakdown)	___	_____	___
200 – Operating Costs	_____	___	_____ (Breakdown)	___	_____	___
400 – Administration	_____	___	_____ (Breakdown)	___	_____	___
500 – Contingency	_____	___	_____ (Breakdown)	___	_____	___

Other headings could be more appropriate depending on the project. Any such vacant unit budget program should be noted in the Public Report under the "Maintenance and Operational Expenses" section.

SUBSIDIZATION OF ASSOCIATION EXPENSES BY SPONSOR - REGULATION 2812.4

Traditional Subsidy Agreement

Under a traditional subsidy agreement a sponsor may elect to decrease, for a specific time, the purchasers' annual assessments by subsidizing or paying to the association in money all or part of the expenses of the association.

Financial arrangements to assure the ability of the sponsor to perform will always be required pursuant to Business and Professions Code Section 11018(i). Regulation 2812.4(a)(3) specifically sets forth this requirement. The bond or other guaranty should be accompanied by escrow instructions to the bond/guaranty holder. The instructions should provide that the security device should not be released or exonerated until escrow holder receives notice from the association that the sponsor has faithfully performed under the subsidization contract. Regulation 2812.4(b)(1). See also Regulation 2812.4(b)(2).

Subsidization Contract

The subsidization contract should be carefully reviewed. It should provide for the monthly payment of the subsidy by the sponsor to the association. The subsidy sum should be clearly set forth. If the sponsor intends to render services or supply goods to the association, the contract should specify in detail the methods to be used in valuing the goods and services.

If the sponsor or an affiliated entity is actually supplying goods or services to the association pursuant to the contract, the sponsor still must pay the agreed value of these goods/services to the association on a monthly basis even though the association will then write the sponsor a check for such goods/services out of an association account. The association should at all times be in a position to control the disbursing and accounting for funds to defray costs attributable to operation and maintenance.

Any subsidy contract submitted should assure that the sponsor contributes to the association a sum allocable to reserves for replacement and major repairs for each unsold interest.

Deficit Subsidy Agreements

For "first-reserved, first-served" time-share conversion projects, in which units are dedicated to the time-share program but are made available for reservations as they are renovated (and are renovated as the sales program progresses) or as they are dedicated to time-share use on a progressive or phased basis, the contract may provide that the sponsor shall pay to the association on a monthly basis the difference between the actual operating costs of the association and the assessments paid by purchasers. In this case, all units in the conversion are subject to assessments whether or not they are renovated or dedicated. This aspect means the sponsor is obligated to pay assessments on all interests it owns in non-renovated or non-dedicated units. Because this burden is unreasonably heavy on the sponsor, it is permitted to pay an unspecified sum each month to the association rather than a full assessment. In most instances, the amount paid is less per interest in non-renovated units than is the assessment per interest paid by purchasers.

This result is not unreasonable in this specific case since many cost elements in the budget upon which a purchaser's assessment is based are not reasonably allocable to non- renovated or non-dedicated units.

For example, given that non-renovated units are not being rented to the public, maid service is a cost allocable only to the renovated units. The association, having the duty to maintain and operate both renovated and non-renovated units, would not have expense of providing maid service to non- renovated

units. Thus, the sponsor would not be obligated to pay for maid service in his monthly subsidy payments to the association.

Reasonable Subsidy Payments

The contract should be scrutinized for any provision which limits the sponsor's subsidy obligation to the per-interest assessment paid by purchasers. Such provisions are reasonable only if purchasers share equally with the sponsor any savings under the subsidy program.

The contract should provide that non-sponsor owners shall not be subject to special assessments during the term of the contract with the exception of special assessments for the construction of common area facilities which are both not part of the original offering by the sponsor and are consented to by the membership of the association.

Sponsor's Contributions to Association Reserves

The contract should also provide for the sponsor's contribution to the association's reserves. The agreement should provide that the sponsor pays reserves for each unsold interest in an amount equal to the amount shown in the association budget allocated to reserves for each interest. Certain fixed cost reserves, such as those for roof replacement, should be shared by the sponsor and other owners of units in the project. However, reserves for replacement of furniture existing only in renovated units is reasonably allocable only to owners of interests in renovated units.

Contract Termination Date

The contract termination date is usually not specific; however, the agreement must contain some type of provision that would activate the termination in order that duration not be indefinite. Normally, it is terminable upon 30 days notice to the association, provided that prior to such termination the sponsor obtain a Regulation 2812.3 bond and upon such termination begin payment of full assessments. Occasionally, in the alternative, it terminates upon the sale of 80% of the interests or a date certain, whichever is first. If 80% of the interests are sold, it is not necessary under Regulation 2812.3 for the sponsor to obtain a replacement Regulation 2812.3 bond for the existing Regulation 2812.4 bond. In such case, the sponsor is obligated to pay assessments on the remaining (20%) unsold units, but is no longer required to bond for the obligation. If it terminates before 80% are sold, the agreement must provide for a 2812.3 bond to be substituted for the 2812.4(a)(4) subsidy bond.

The amount paid by the sponsor as a "subsidy" is not ascertainable, under the type of program mentioned above, because the monthly amount and the duration is not known to the Deputy. As a matter of policy, the Deputy should require the Regulation 2812.4 bond amount to be equal to 1/2 of the association's first year annual budget.

Subsidization Pitfall

Since the purpose of many time-share conversion program subsidy contracts is to reduce the sponsor's assessment obligation (the Declaration normally provides that the sponsor may pay the subsidy in lieu of regular assessments) it is actually a misnomer to call this arrangement a "subsidy program" at all. Purchaser's assessments are based on a budget covering all units as though all were renovated and furnished and their assessments are not reduced under the "subsidy program". Subsidy contracts will also be reviewed by the Budget Review Unit for adequacy.

When This Type Of Subsidy Is Not Permitted

If the time-share units are part of a condominium, planned development or other Common Interest Development, a "Deficit Subsidy" will not be permitted for the master association. This type of subsidy shall only be made available for time-share association.

Deficit Subsidy – Budget Review Considerations

Since the sponsor's obligation under a Deficit Subsidy Agreement (DSA) would have a significant impact on the association's ability to meet its financial obligation, the Budget Review Unit should be consulted so that they may add their input over those areas that will affect the association.

It is incumbent upon the Budget Review Unit to determine what method the sponsor will utilize in order to calculate the deficiency amount. Since it is to the benefit of the sponsor to apply any source of revenue generated to offset its deficit payment obligation, the only revenue(s) allowable should be limited to assessments and interest. The reasoning is that all other generated revenue should be set aside for the purpose for which it was generated in the first place (i.e. revenue from renting the recreation facility should be earmarked to offset acceleration of its wear-and-tear). Also, the sponsor's obligation should not be limited to either line-by-line costs or assessments that should have been collected.

In addition, there should be a provision that covers the sponsor's obligation to provide monthly accounting with a yearly reconciliation. Both of these requirements will ensure that funds will be available to cover any association obligations and the yearly reconciliation would apprise the association whether its assessments are either too high or too low, based on the amount of subsidy paid by the sponsor.

Finally, there should be a provision(s) that covers the sponsor's security obligation, and whether the DSA should be amended or accepting an amendment with the original attached. For example, both are somewhat linked together for the following reasons. Ordinarily, the security obligation is based on 50% of the annual association budget; however, should the association elect to change the annual budget it would effect the security amount. As to the amendment to the DSA, its not unusual for the sponsor to submit only the amendment to the DSA, which covers only the provisions being amended. Since projects may extend into 50+ amended filings, it is extremely difficult to determine whether the amendment satisfies the DRE's current policies, Regulations, or the B&P Code. Therefore, both documents should be physically linked.

Public Report Disclosures for Subsidy Programs

The Public Report for any time-share project which incorporates a subsidization program should include disclosures suggested by the guideline set forth in III.B.7.a. of the Subdivision Manual. Although the subsidy program in this manual differs from that program described in the Subdivision Manual, there are similarities between the two. These disclosures should be set forth under the "Maintenance and Operational Expenses" section.

ESCROW INSTRUCTIONS

Escrow instructions must be completed in sample form to show the substance of a typical transaction, and be signed by an escrow officer or his designee and the subdivider verifying that all escrow instructions will conform to the sample.

All Time-Share Buyer's Escrow Instructions Shall Include the Following Provisions:

Return of Purchaser's Funds when Escrow Exceeds Time Limit

A provision for return of all purchaser's funds to non-defaulting buyer in the event escrows are not closed on a reasonable date; i.e., three months, six months, nine months or up to a maximum period of one year. The appropriate deadline must be clearly specified. See Regulations 2810(a)(12)(D) and 2791.

Impounding Purchaser's Funds
The selected method of impounding purchaser's funds must be clearly indicated in the escrow instructions. For example, if the developer selects impounding under Business and Professions Code Section 11013.2(a), the escrow instructions should clearly recite the requirement of the statute.

Statutes and Regulations Pertaining to Escrow Instructions
Depending on the representations of the developer in the filed questionnaire, escrow instructions may be needed to conform to the following statutes and regulations:

- Business and Professions Code Section 11018.5(a)(2) – See appropriate provisions in the Subdivision Manual.
- Regulation Section 2812.3 or in the alternative.
- Regulation Section 2812.4.
- When applicable, presale requirement for the deposit of contract in trust pursuant to Regulation Section 2812.2.
- Civil Code Section 1134, where applicable (time-share units in condominium conversions).
- Conveyance of personal property to the association free of liens as discussed below.

PERSONAL PROPERTY
Personal property may include furniture, appliances, window treatments, floor treatments, linen package, dishes and utensils, boats, automobiles, skis and other properties exclusive of buildings and grounds. The personal property is equivalent to common area if it is available for use by interest owners and Business and Professions Code Section 11018.5 applies. The personal property must be conveyed or leased to the association or conveyed by fractional interests to the interest owners. Such property may also be conveyed to an acceptable trustee whose duty would be to retain title to the property for benefit of the interest owners and to protect the property against third party claims.

Conveyance of Personal Property
Business and Professions Code Section 11018.5 mandates that the personal property be conveyed prior to issuance of the Public Report or prior to close of the first escrow with appropriate assurances of conveyance, free of liens and encumbrances. Adequate financial arrangements for purchase and placement of the property in the project must be provided.

Personal Property Conveyed Outright to an Association
When personal property is conveyed outright to the association, the event is effected by a bill of sale. The escrow instructions should include a provision requiring delivery of the bill of sale which includes, as an exhibit, the inventory of personal property, to the association prior to the close of escrow of the first sale. In order that escrow can verify that the inventory attached to the bill of sale is correct, a proper inventory should be attached to the escrow instructions and referred therein. The inventory should include the remaining life and replacement cost of each piece of personal property. The escrow must also state that the personal property will be delivered to the association and the personal property placed in the dedicated units or appropriate location for use prior to close of escrow.

Personal Property Leased to an Association

If the personal property is to be leased to the association, the terms of the lease must be studied carefully to determine the duration of the lease, the amount of lease payments, conditions under which the lease may be terminated and any other aspects of the lease which might create unfair, inequitable, burdensome conditions for the association. If the sponsor is to be the lessor under a lease arrangement in which the personal property is leased to the association, the arrangement must be scrutinized carefully to determine reasonableness. In all cases the Subdivisions Deputy should be certain that the Budget Review Deputy has determined that lease payments are properly included in the association budget. The escrow instructions should include a provision which requires delivery of the lease to the association and the installation of the leased property to the project prior to closing of the first escrow.

Free and Clear Conveyance of Personal Property

To insure free and clear conveyance of the personal property, the escrow instructions should include a provision which requires that prior to close of escrow, a U.C.C.-3 Form will be issued by the Secretary of State to the association indicating that there are no financing statements on file naming the sponsor and/or lessor. A financing statement (U.C.C.-1) is a document filed with the Secretary of State by a creditor declaring security interests against an individual or entity for specific types or items of property.

Deputies should not ordinarily approve an arrangement whereby the sponsor proposes to convey individual interest in the personal property to purchasers. If such a proposal is made, the sponsor should provide written support for the arrangement, which includes the reasons for not proposing to convey the personal property outright to the association.

RENTAL OF UNITS

In a project in which the occupancy of units is on a first-reserved, first-served basis, the Declaration may include provisions for the rental by the managing agent to the public of dwelling units not timely reserved by the interest owner in compliance with the provisions of Regulations Section 2812.9.

Sponsor Rental Restriction

The purpose of the regulation is not to prevent the sponsor from renting use periods ***nor*** to prevent the sponsor from receiving rental proceeds from renting use periods to which the sponsor was entitled as an owner of unsold time-share interests; however since the sponsor is in a position to advance his own interests at the expense of other owners (especially if the sponsor is the manager), the sponsor must be limited in its ability to reserve occupancy periods in accordance with the applicable provisions of Regulation 2812.9.

That is, as long as the managing agent is an entity owned or controlled by the sponsor, or is an entity under common management and control with the sponsor, the Declaration must contain provisions which prohibit the sponsor from reserving any period for the purpose of rental to the public until expiration of the regularly prescribed time for making reservation [Regulation 2812.9(b)] and which prohibit the sponsor from reserving a period earlier than 45 days before the first day of that period [Regulation 2812.9(d)(2)].

Sponsor Receipt of Rental Revenues From Rental to Public

The regulation does not prevent the sponsor from receiving rental revenues from periods not timely reserved by non-sponsor interest owners after all time-share interests have been sold. However, under Section 2812.9(d) of the Regulation, the association has the power to vote to disallow the sponsor from receiving such revenues. Regulation 2812.9(b), which states that a sponsor may not reserve any occupancy period for the purpose of renting it to the public until expiration of the regularly prescribed

time for making of reservations for that occupancy period by other owners, should be applied whether or not all of the time-share interests have been sold.

It is only feasible, in most time-share projects, that the sponsor control the managing agent as survivability of the time-share project often depends on the knowledge and/or experience of the sponsor in time-share management. Thus, subdivision (d) is written so that rental revenues accrue to the sponsor only so long as the sponsor or an entity controlled by the sponsor, is the managing agent. But there must be controls on this right, resulting in the other restrictions written into the regulation.

Rental to Purchasers Prior to Close of Escrow

Sometimes, sponsors who offer time-share estates wish to allow purchasers to use the units before close of escrow. This is permissible, provided the purchaser pays a separate rental fee for the use period and enters into a separate rental agreement.

Rental Fee Refund

If the sponsor wishes to "refund" the rental fee to those buyers who use the property and later close their escrows, the sponsor may do so only by crediting that amount to subsequent monthly payments. A "guaranteed refund" would require impounding that amount to be refunded. No impound is necessary if the rental fee is credited to any future monthly payment made after close of escrow.

Buyers Default After Renting

Buyers who default under the purchase agreement after using the property would not receive a refund or credit. That rent was earned by the landlord-sponsor. The (separate) purchase money deposit must be handled pursuant to Code Section 11013.2 or 11013.4 and Regulation 2791.

Monthly Payments to Sponsor Prior to Close of Escrow

The sponsor can accept monthly payments from purchasers for a period not to exceed 6 months prior to close of escrow. All monthly payments made prior to close of escrow must be refunded if the time for close of escrow (a maximum of one year from opening of escrow) expires and the parties do not agree to an extension of escrow.

Sponsor Waiver of Rights to Accelerate

The sponsor must waive whatever rights he may have under the terms of the note to accelerate the note and claim the total amount due in case of default by the purchasers in making payments prior to close of escrow, if the sponsor wishes to be allowed to accept payments beyond the initial deposit.

MANAGEMENT AGREEMENT

The Declaration of Dedication shall require the employment of a managing agent for the project pursuant to a written management agreement.

The management agreement shall ordinarily include the provisions enumerated in Regulation 2812.8(a), Subsection 1-14. Sometimes, the Declarant recites the required provisions of the management agreement in the Declaration. While this is not objectionable, it does not excuse the requirement for submission of a copy of the executed management agreement between the association and selected managing agent prior to issuance of the Public Report.

Compensation to Manager

Usually management agreements provide for compensation of the managing agent to be measured by a specified percentage of the maintenance and operation expenses.

The Department has taken the position that compensation of the managing agent shall ordinarily not exceed 10% of the association's budgeted maintenance and operational costs, less the manager's compensation. If provisions in the Declaration provide for conditions under which compensation may exceed 10% maximum, then a vote of the majority of the members of the association (excluding the subdivider) should be imposed as a concurrent condition. It will be the responsibility of the Budget Review Deputy to determine the reasonableness of the initial compensation allocated to the managing agent.

The Budget Review Unit should be cautioned, when reviewing these agreements, to watch for provisions that allow accelerator clauses or pass-through fees. These should be considered unacceptable without appropriate contractual obligations. For example, agreements that state "10% for year one, with incremental increases of 12%, 18-months, and 15% at 24-months" should be disallowed. Further, agreements that state "auditors fees, legal fees, etc. shall be paid directly to the management" should be disallowed, unless a separate contract is submitted for review.

Error By Managing Agent and/or Monetary Compensation to Damaged Owner. (Regulation 2811(a)(12))

If, due to the error or negligence of the association or the managing agent, a dwelling unit cannot be made available for the period of use to which an owner is entitled by schedule or under a reservation system, the association is obligated to provide such owner with compensating use periods or money. This duty should be set forth in the Declaration.

The measure of monetary damages should be set forth in the Declaration as 100% of the fair rental value of the dwelling unit, which may be set forth as that amount customarily charged by the sponsor for a similar unit when rented to the general public. Alternatively, the fair rental value may be set forth as the rate charged by the association to members who rent unreserved occupancy periods. In no case should the fair rental value be set by comparison to discounted rental rates charged by the sponsor or the association.

Although this requirement of Regulation 2811(a)(12) is directed to time-share estate projects, Deputies should assure that this measure of damages is set forth in the Declarations of both use and estate projects.

FIDELITY BOND – REGULATION 2812.8(a)(11); REGULATION 2812.10(c)

Protection of Association

The Deputy should assure that the association is protected against the risk of loss of funds stolen or embezzled by its managing agent, the agent's employees or the agent's independent contractors.

Association as Insured Party

The fidelity bond should name the association (not the managing agent) as the insured party. Most bond formats insure the insured party only against its own employees. As the managing agent is an independent contractor, it is often necessary to insist that an "agent's rider" be attached to the bond. This rider typically expands the definition of the association's employees to include its independent contractors.

Fidelity Bond Issuance

The fidelity bond should be issued by a reputable bonding company acting through an authorized agent. A special power of attorney should be attached to the bond.

Fidelity Bond Held

The original bond need not be held by an escrow holder but may be held by the association. Since the time-share Restrictions must provide that the managing agent be bonded, the obligation is a continuing one terminable only if the agent resigns or is dismissed by the association.

Bond Amount

The bond amount, as a matter of policy, is based upon the amount of the association's funds at risk. Ordinarily the calculation is (annual reserves x 2) + (maximum amount in general fund during the year). The amount present in the general fund will depend upon the frequency of assessment collection by the association, which should be set forth in the time-share Restrictions. Deviations from the formula should be reviewed with your immediate supervisor.

Waiver of Fidelity Bond

The fidelity bonding requirement may be waived, if title to the property has been conveyed to a trustee pursuant to Regulation 2812.2 and if the time-share Restrictions provide that all assessments are to be paid directly to the trustee. Any such arrangement should be plainly set forth in the trust agreement as well, with specific instructions to the trustee on how such funds will be disbursed to pay association expenses. The trust agreement should provide that the trustee holds these funds exclusively for the benefit of the association and for the benefit of no other trust beneficiary. Any such trust arrangement should be reviewed by the Legal Section.

MIXED COMMERCIAL AND TIME-SHARE PROJECT

Dwelling units to be dedicated to time-sharing use may be situated within a facility which includes dwelling units which will be utilized as rentals and/or a restaurant, bar, stores or other commercial establishments. In such mixed use projects, the provisions of Regulations Section 2812.7 are applicable.

When the project is a time-share estate offering in which the project includes commercial establishments, it is necessary to determine whether those establishments will become conveyed to time-share interest owners or the association. The sponsor may attempt to retain ownership of these businesses under the theory that ownership of such profit-making enterprises by a non-profit incorporated association would constitute a security requiring registration with the Department of Corporations. The fact that a time-share estate purchaser may derive a pro rata monetary benefit from rental payments by the lessee of a commercial adjunct to the time-share project probably does not create a security out of the time-share estate being sold. Unless an investment contract is offered in the sale, it is doubtful that ownership of a business by an association of interest owners would constitute a security if the income to the association is incidental.

If qualification of the project with the Department of Corporations or the SEC is necessary, a Public Report must not be issued without evidence of a prospectus from the Department of Corporations/SEC, or a written opinion of counsel or a written statement from the Department of Corporations that the project does not require registration. If the project is still in the planning stages, you should implore the sponsor to segregate the commercial facilities and the property containing the time-share dwelling units through a lot split or other means.

If the sponsor is unable to facilitate such a lot split, and the time-share interest owners (or the HOA) will have a proprietary interest in the commercial facility, it would normally be considered reasonable for the association to operate the business if the profits are nominal as there would be no securities issued.

If however, the sponsor presents evidence from the Department of Corporations or the SEC stating that this type of an offering would be considered a security or if the non-profit status of the association

would be jeopardized in operating such an enterprise, alternative arrangements for operation of the business should be made. For example, provisions may be made within the management documents to prohibit the association from engaging in such activities. Other than such a prohibition, the only other reasonable alternative would be a long-term agreement (i.e., lease) between the association and a third party so that the latter would be obligated to maintain and operate the facility. This type of agreement must not benefit the commercial operator to the detriment of the association. It must be remembered that this is property owned, directly or indirectly, by time-share interest owners; thence, some of the benefits derived from the commercial operation should inure to the owners. The primary benefit to the owners would be rent paid by the operator to the association which would be used to defer a portion of the association's operating expenses. As long as the amount of the rent is "nominal" (for example, $1.00 per time-share interest per month), and is utilized exclusively to offset costs, the Department of Corporations probably would not question the association's non-profit status. As with any dwelling unit that has not been dedicated to time-share use, the reviewing Deputy should ascertain whether the operator is properly obligated to maintain the interior of the facility and to pay, to the association, its proportionate share of monies (apart from the rent described above) in order to maintain the common or public areas. This type of an agreement should be reviewed by both a staff attorney and the appraiser assigned to review the budget in addition to the Deputy.

Equitable Allocation of Operating Costs

In a project wherein there are commercial units and/or other commercial facilities that share the use of common areas or facilities with the time-share unit owners, the governing instruments must provide for provisions for equitable allocation between the time-share project and the commercial operation of costs of management and operation incurred for the joint benefit of the time-share project and the commercial facility. The sponsor must covenant, through the Declaration of Dedication, to reasonably allocate such costs by a mechanism defined therein. The actual procedures for reasonable allocation of these costs and for implementing control of the allocation system may be prescribed in the CC&Rs or by separate contract between the association and the sponsor.

The fairness of the expense allocations in the cost sharing instrument will normally be evaluated by the Budget Review Deputy. If compliance with Regulation Section 2812.7 is based on either specific provisions in the Declaration or a separate agreement, the following are essential ingredients of the allocation schedule:

Square Footage Allocation Method

The allocation of expenses should be based on the square footage of the commercial facilities in relation to the total project.

Property Taxes – Commercial Property

The sponsor must pay the property taxes for the commercial property. If the tax bill for the entire property is delivered to the association, the sponsor must agree to pay his proportionate share for the commercial facility. The agreement should spell out the sponsor's liability for increase in the property taxes due to the existence of the commercial facility.

Utilities and Services

The sponsor must be responsible for all costs of utilities and services to the commercial facility or the undedicated dwelling units.

Liability Insurance

The sponsor ***must*** obtain a policy of liability insurance insuring the association against any liability arising out of ownership, use or occupancy due to personal injuries or death. A policy of hazard

insurance in amount equal to at least 80% of the full replacement value of the structures should be obtained in which the association should be named as additional insureds.

Liability for Operating Expenses
The liability for operating expenses should be allocated among the time-share interest owners and commercial operator(s) according to the ratio of square footage between the two operations.

Separate Book and Records – Commercial
There must be provisions requiring separate books and records for the commercial operation.

Reciprocal Easements
The Declaration must include provisions for reciprocal easements between time-share units and commercial facilities if the nature of the project deems cross-use rights necessary.

ANNEXATION

Phasing and Dedication of Time-Share Dwelling Units

The time-share regulations do not address the issue of annexation in the sense of the normal application of that term. Regulation 2810.4 refers to the addition of dwelling units to the project and evidently does not consider the question of the annexation of dwelling units located on land adjacent to the initial project. In reviewing the annexation/dedication procedures in time-share CC&Rs the Deputy should ensure that the sponsor's rights to unilaterally annex units or property is limited to a defined overall plan of development that will not result in a diminution of benefits, or an increase in the burdens, upon the existing members in the project. Regulation 2792.27(b) may be used as a guide for evaluating the development plan.

An issue of concern to the Department relating to questions of annexation is, "Under which conditions must the Public Report be amended or a new filing made?" The following procedures shall be followed for the given fact patterns:

Adjacent Land Annexation
Annexation of adjacent land on which dwelling units are or will be, located and made part of the project subject of the original Public Report and amendments thereto, if any: Under these circumstances, a separate Notice of Intention is to be filed and the procedures under Regulation 2810.4 shall apply. However, because of the inherent difficulties in predicting the effects of annexation of adjacent land to the existing project, more constraining procedures than those found in Regulation 2810.4 are necessary, such as those suggested by Regulation 2792.27.

Addition of Dwelling Units Located on Same Parcel
If the annexation pertains only to addition of dwelling units located (existing or subsequently built) on the same land on which the time-share dwelling units identified in the original Public Report are located, an amendment to Public Report shall be necessary for each dwelling (or group of dwellings) added to the project. The annexation or addition of dwelling units will usually be accomplished by the filing of a Declaration of Annexation or other instrument identified in the Declaration of Dedication.

DEEDED RIGHT TO USE

A "Grant Deed" to convey a right-to-use interest in a time-share property is in the nature of a leasehold interest as deduced from the Cal-Am decision. This type of conveyance document is recordable.

Property Not Subject to Blanket Encumbrance

If evidence is received that policies of title insurance insuring the time-share use interest conveyed to any purchaser are available from an established insurer and the time-share property is not subject to a blanket encumbrance, the dwelling units need not be conveyed to a trustee. With conveyance of the time-share use interest by recorded grant deed and policy of title insurance to insure the interest, there is no purpose served to insist that the property be conveyed to a trustee.

Special Note for Public Report

When a Public Report is drafted for a "Deeded Right-to-Use" project, include a special note informing prospective buyers that an owner of a time-share interest in this kind of project will not receive title to any portion of the property. He/She will receive merely a right-to-use the property for a specific number of years.

LIQUIDATED DAMAGES – TIME-SHARE PROJECTS

Contracts – Time-Share Estates

Contracts for the sale of time-share estates that contain provisions for liquidated damages due to default by purchaser must also contain provisions that comply with Regulation 2791. This regulation applies to in-state or out-of-state time-share projects so long as the purchasers will all receive time-share estates.

Anti-Deficiency Judgment

The Department has taken the position that the anti-deficiency judgment provisions of the Code of Civil Procedure, Section 580(b), are applicable to sales of either time-share uses or time-share estates. Each such contract or financing instrument should contain a statement where the subdivider declares he will not seek a deficiency judgment in the event of a default by a purchaser.

RESCISSION RIGHTS

In accordance with the provisions of Section 11024 of the Business and Professions Code, a person who has made an offer to purchase a time-share estate or time-share use in a time-share project subdivision shall have the right to rescind any contract resulting from the acceptance of the offer until midnight of the third calendar day following the day on which the prospective purchaser executed the offer to purchase.

Rescission Rights Notice

To inform a person of his or her right to rescission, the sponsor shall attach to the face page of every copy of a Subdivision Public Report given to a prospective purchaser the notice as set forth in Commissioner's Regulation 2813.13. In addition, a "special note" describing these rescission rights is to be shown on every Public Report where the subdivision is a time-share project. See form RE 615 for the language which is to constitute the "special note."

HUD/Interstate Land Jurisdiction

If the project is subject to HUD/Interstate Land jurisdiction, the Public Report should include any extra rescission rights that are provided by federal law.

Out-of-State Projects

In the case of out-of-state projects, the California rescission rights will apply regardless of any rights of rescission in effect where the project is located.

TRUSTS

Department Regulation 2812.2 requires that title to units in all time-share use projects and in those time-share estate projects that are subject to monetary encumbrances be conveyed to a trustee. (See comments under ***Subordination*** for exceptions.)

Trust Agreement

In a typical time-share trust agreement, the sponsor is the trustor, a bank is the trustee, the holders of the underlying encumbrances are the primary beneficiaries; the sponsor is the secondary beneficiary, and the owners' association is a third party beneficiary if not a party.

Trust for Time-Share Use Projects

When the property is a time-share use project that is not subject to blanket encumbrances, the trust is essentially a passive one, and must include the provisions listed in Regulation 2812.2(b).

Compliance With DRE Regulations

Any time dwelling units in a time-share project are conveyed to a trustee under a trust agreement, the Deputy must ensure compliance with all provisions of Regulations 2812.1 and 2812.2.

DRE Legal Review

All trust agreements in time-share projects are to be reviewed by the Department's Legal staff. The Deputy assigned to the file must also review the trust. Particular attention should be paid to the following provisions when and/or if required to be part of the trust:

Transfer Prior to Close of Escrow

All property to be conveyed to a trustee must be transferred to the trust prior to the closing of the escrow for the first sale of a time-share interest in a dwelling unit in accordance with Regulation 2812.1.

Whenever title is to be transferred to a trustee pursuant to Regulation 2812.2, evidence of the conveyance must be submitted as part of the filing prior to issuance of a Final Public Report.

Termination of Trust

A trust for a time-share use project may not terminate before the termination of all of the use rights; a time-share estate trust may terminate at any time after the encumbrances have been paid off.

Deposits to Trust

Ensure the provisions of the trust instrument clearly spell out the requirements and the procedures for insuring that adequate funds, contracts and/or promissory notes are deposited into the trust by the sponsor as funds are disbursed or notes and contracts paid off.

Acceptable Trustees

Refer to Regulation 2791.6 for acceptable trustees.

SUBORDINATION

Most time-share offerings will comply with Sections 11013.2 and 11018.5(c) of the Business and Professions Code with (1) individual releases from the blanket encumbrance(s) for each time-share interest, and (2) subordination to the time-share Declaration by the beneficiary of each blanket encumbrance. Procedures for proper implementation of subordination and individual release clauses may be found in the Subdivision Manual.

If releases from the blanket encumbrance(s) and lender subordination to the time-share declaration are not available, Regulation 2812.2(c) "ordinarily" requires, pursuant to Section 11013.2 of the Business and Professions Code, that each of the dwelling units in a time-share estate project that is subject to a blanket encumbrance be conveyed to a trustee acceptable to the Department prior to the closing of the escrow for the first sale of a time-share estate which entitles the purchaser to occupy the unit in question.

TAXATION

Local Juridictions

Each local jurisdiction has its own method of assessing time-share interests or dwelling units for real property tax purposes. Determine from the tax assessor how taxes will be assessed, including not only how the units will be appraised but how the individual owners will be billed. This information is normally obtained in a letter from the local tax assessor and should be included in the Public Report.

Appraisal of an Interest

Quite frequently, the valuation of time-share interests will be based on sales prices of the interests. If the tax assessor has not decided how the interests will be re-appraised the Public Report should disclose said indecision, in addition, to current estimated taxes and potential tax liability if based on sales prices. Use an example in the Public Report so potential buyers may easily understand how to calculate their potential tax obligations.

Tax Bill

In some cases, the tax bill for the entire property will be sent by the assessor to the association or trustee (if one is involved in the project), which will then bill each owner his respective portion of the tax obligation. The interest owner will, in turn, normally remit his payment for taxes to the association as part of his periodic assessment. Sometimes, the tax obligation for interests owners will not be included as part of the regular maintenance assessment and will be paid to the association separately from the regular assessments. This may be discussed with the Budget Review Deputy who reviewed the budget for the association and appropriate provisions should be spelled out in the Declaration.

The Public Report should reflect the method by which the owners shall be assessed for tax purposes.

Increase in Regular Assessments

It is incumbent upon the Deputy to assure himself/herself that provisions have been included in the Declaration which excludes an increase in regular assessments attributable to an increase in real property taxes in determining whether the annual assessment has increased more than 20% greater than the regular assessment for the preceding fiscal year.

Additional Taxes

The Subdivision Deputy and the Budget Review Deputy should also determine whether any other taxes will be imposed, such as transient occupancy taxes or bed taxes, and find how they are to be imposed. He/She should require that such taxes are covered adequately in the Declaration, the budget and/or the purchase agreement. The Public Report should include disclosures concerning these taxes if there are any aspects to these taxes that might affect the purchaser’s decision to purchase an interest.

LOCAL ORDINANCES

Some local governmental authorities have enacted ordinances that impose restrictions and conditions for compliance prior to permitting the dedication of dwelling units to time-sharing.

Sponsor Compliance

The sponsor must furnish a copy of the Permit or other entitlement for time-share use from the local governmental agency prior to issuance of a Public Report. For purpose built time-share projects, the consent of the local authorities can often be found in the conditions of map approval. This requirement may also be satisfied with a copy of the letter by which the sponsor gave notice of the proposed dedication to time-sharing to the appropriate local government agency.

COASTAL COMMISSION

The California Coastal Commission, on January 24, 1980, voted unanimously to "assert jurisdiction" over the conversion of hotels and motels in California's Coastal Zone to time-share projects. They have also asserted jurisdiction over the implementation of time-share conversions in other properties, such as condominiums.

The Coastal Commission's position on time-share projects is supported by a 1980 California Court of Appeals decision on Cal Coastal Commission v. Quantam Investment Corporation (113cal.ap.3rd579) in which an apartment project was being converted to a stock cooperative.

Sponsors with projects in the California Coastal Zone fall into one of two categories and must comply as indicated:

(1) **New Construction** – Submit copy of Permit or Exemption from the Coastal Commission.

(2) **Conversion** – Submit copy of letter notifying the Coastal Commission of the sponsor's intent to dedicate units to time-sharing.

INVENTORY CONTROL

As part of the Notice of Intention time-share developers are required to demonstrate to the DRE that a reliable system of inventory control has been created to manage the sale of time-share interests and limit sales to the number of interests authorized in the Public Report or Permit. The DRE's authority for requiring a reliable system of inventory control is derived from Sections 11018(b) and (c) and 11018.5(e) of the Business and Professions Code.

The DRE's review of inventory control systems in time-share projects is much more critical than in other types of subdivisions because, unlike lot or condominium subdivisions where the real property divisions are clearly defined by maps approved by the local government, time-share interests are created by time-share declarations approved by the DRE. The time-share declaration essentially divides the time-share property into time increments.

Certain title companies will monitor the sale of intervals in time-share estate projects and issue DRE acceptable preliminary title reports that define the underlying real property, as well as the unsold time-share intervals. Inventory control for time-share use projects can be more difficult to track without recorded deeds of conveyance for reference.

In the most basic time-share offering where all the intervals are identical, e.g. one week, one room size and one season, an interval identification system could be established simply by sequentially numbering the intervals from one to the total number of intervals in the project. The total number of intervals in the project would equal the number of dwelling units multiplied by the number of weeks. Unfortunately, time-share interval identification systems are rarely as simply as this hypothetical time-share offering. Most time-share offerings include a variety of different interval types to satisfy different consumer demands.

If the time-share project will include more than one type of interval, such as room size, season, etc., the time-share declaration must clearly define the system of identifying each type of time-share interval to be sold. Typically, this is done by assigning each interval a unique number that is defined in the declaration and listed on the deed or contract given to the purchaser. This will enable the sales to be identified by interval number that can be used in monitoring sales within each type of interval, as well as the total interval sales number.

The developer may propose to control the sales of inventory by listing only the fractional undivided interests in the project on the deed or contract without using an interval number linked to the numbering system defined in the time-share declaration. In a project where different interval types or seasons are being sold, the fractional interest being conveyed for the use of a one bedroom unit may be the same as the fractional interest conveyed for a two or three bedroom unit. Similarly, the fractional interest appurtenant to a premium season may be the same as the fractional interest appurtenant to a low season interval. To allow proper sales monitoring and prevent over selling within a particular unit type or season, it is critical to distinguish between the unit types being sold with unique interval numbers. Often the interval identification number will be comprised of a series of numbers, such as the dwelling unit number, week number, and season designation number.

In a points based time-share program, where the sponsor is selling points that may be redeemed for the use of the project dwelling unit s, the total points and system of points allocation of use rights should be defined in the time-share declaration. The number of points assigned to the use of all dwelling units should not exceed the available units in the project. For more complicated points programs, the Deputy should request an independent CPA's reconciliation of the proposed point allocation schedule set forth in the time-share declaration.

Inventory control in time-share estate project can be monitored by inspecting the recorded conveyance deeds in the public record, provided the proper interval identification system has been established in the time-share declaration, as discussed above, and properly noted in each deed of conveyance. For time-share estate projects, the Deputy should request written confirmation from a title insurance company explaining the procedures the title insurance company will follow in monitoring sales.

Inventory control proposals in a time-share use project may be much more tenuous. Some options for creating an inventory control system in a time-share use project are:

(1) recording the sale contracts, although the DRE has taken the position in the past that this cannot be required;

(2) inventory control by an acceptable trustee (See Regulation 2791.6) when title is held in trust; or

(3) monitoring by an independent third party CPA, which would be the least desirable of these three options.

The Deputy is encouraged to consult with DRE Subdivisions management and Legal staff before accepting a time-share use inventory control proposal.

In ***all*** time-share projects, the DRE-approved system of time-share interval identification must be clearly set forth in the projects management documents, along with a covenant by the developer not to sell more intervals than the DRE agrees will be available for shared use and proper maintenance of the project.

TITLE

To satisfy the requirements of Section 11018(c) of the Business and Professions Code, time-share Public Report applicants must provide evidence of the ability "...to deliver title or other interest contracted for". Typically, evidence of title for time-share projects is provided in the form of a preliminary title report with the DRE special note, as is provided with other types of subdivisions.

Time-share use offerings require title be protected in trust, as further discussed herein under ***Trusts***.

In time-share estate offerings the purchaser receives a right of occupancy in a time-share project which is coupled with an estate in the real property. If the time-share project is divided into equal occupancy rights coupled with equal estates in real property, as in the basic hypothetical example given under ***Inventory Control*** herein, the purchasers use rights would always be accurately defined by his fractional fee interest in the property. In this example the title evidence required from a Public Report applicant need only to define the applicants undivided fractional fee interest in the real property, because the right of occupancy always equals the estate in real property. The same title evidence requirements would apply to a points based time-share estate project wherein the purchasers use rights is defined by his undivided fractional fee interest in the property and the fractional fee interest is made up of the number of points purchased, divided by the total number of points in the project.

As explained under ***Inventory Control***, time-share estate offerings are often divided into equal estates in real property coupled with unequal rights of occupancy. For example, the purchaser of a one bedroom low season unit may receive the same undivided fractional fee interest in the project as the purchaser of a three bedroom premium season unit. Therefore, it is critical that the title evidence requirement for this type of time-share estate offering include, in addition to the fractional fee interest in the project, an exact definition of all the use rights that are coupled with the fee estate in real property. The title insurance company will provide an additional exhibit to the title report that list the intervals owned by the applicant, provided the interval identification and inventory control system has been adequately defined in the time-share declaration.

MULTI-SITE TIME-SHARE PROJECTS

Multi-site projects are defined in Business and Professions Code Section 11003.5(f) as an arrangement wherein a purchaser obtains the recurring right to use and occupy accommodations or facilities in a time-share project consisting of more than one component site through use of a reservation system on a non-priority basis.

This statute further provides that an exchange program in which the purchaser's total contractual financial obligation does not exceed $3,000 per time-share interest is not a multi-site time-share project. The $3,000 limitation is determined by any initial membership fees payable by the purchaser in addition to any fees payable to renew that purchaser's membership with the exchange program and any other fees or charges payable over the life of the exchange program's relationship with the individual purchaser. If the total financial obligation exceeds $3,000, the exchange program must be qualified as a multi-site time-share project.

Multi-Site Time-Share Project Applications

At the time the initial application is made, a RE 668A must be completed and for each component site. Because the documents for the reservation system and organizational documents for the operation of the multi-site time-share program and documents to be utilized for the purchase and marketing of individual interests will be applicable to all of the component sites, those documents should be submitted with one of the RE 668As. The file that includes that RE 668A will be treated as the "Master File" for the project.

How a Multi-Site Time-Share Project Works

Purchasers of time-share interests in a multi-site time-share project may be conveyed either a time-share estate or a time-share use. A multi-site time-share project in which time-share estate interests are conveyed are rare. If the interest conveyed is a time-share estate, the purchaser would receive a deeded interest in one of the component sites. For purposes of his or her rights to use and occupy dwelling units in the multi-site time-share project, the deeded interest conveyed to that purchaser would have no meaning. That purchaser would not have any superior right to use and occupy dwelling units in the site in which he or she received a deeded interest over and above other owners of interests in the multi-site time-share project.

Multi-site time-share projects more commonly involve the sale of right-to-use interest wherein the terms of the purchase and conveyance are included in the purchase agreement. The purchase agreement will describe the basic nature of the reservation right the purchaser receives. The purchase agreement might state the purchaser has the right to use any unit of a certain type every year or only during a certain time of year. The purchase agreement also may involve the assignment of points, which is another way to determine the value of the reservation rights purchased. The more points one purchases, the greater flexibility that purchaser has in making reservations to use dwelling units in the component sites. Refer to ***Time-Share Points Programs*** for more information on this topic.

The component sites may include entire subdivisions, selected individual dwelling units in pre-existing time-share projects or in other types of subdivisions or it may be merely involve a few fractional interests in an existing time-share project unrelated to the multi-site time-share project.

There is usually bifurcated management for time-share projects. An "administrative" management agreement, which is a contract between the managing agent and the owners' association for the multi-site time-share project, administers the reservation system and performs other duties as established in that contract for the purpose of operating the multi-site time-share project. Then there is the "on-site" manager, which performs maintenance and operational duties with respect to the individual component sites. On occasion, the management agreement may encompass both administrative and on-site management duties. Any management agreement must be reviewed by the Subdivisions Deputy and by the Budget Review Deputy for regulatory compliance.

Review of Governing Documents

If the multi-site time-share project includes an out-of-state component site, that site's governing documents should be reviewed carefully for compliance with California's time-share regulations and, if applicable, the regulations for other common interest subdivisions. Often, multi-site time-share project governing documents for out-of-state subdivisions are drafted to meet the situs state's laws and regulations because the project originates in another state. If the time-share project is burdened by an underlying common interest subdivision, a completed RE 648 must be submitted by the sponsor.

If there are provisions of governing documents for either the time-share project documents or the component site common interest subdivision documents that do not meet California regulatory requirements, the sponsor should provide either authoritative legal support for those provisions (such as copies of the situs state's statutes or regulations that require the provisions) or other justification for the contrary provisions. It may be helpful under certain circumstances to request that the SRP submit copies of the situs states' statutes to confirm whether certain provisions are mandated.

In making decisions whether to accept non-complying provisions, the Deputy's primary duty should be focused on ascertaining whether the documents provide for the reasonable arrangements required under

Business and Professions Code Sections 11018.5(d) and (e). If the documents do not meet those standards, the documents should be rejected.

Generally, the sponsor must make a compelling case in order that the Deputy might consider accepting a non-complying provision. If, for example the provision is in place because of the mandates of the situs state's statutes, the Deputy must make a judgement whether the existence of the provision would obstruct the preservation of the reasonable arrangements of Business and Professions Code Sections 11018.5(d) and (e). Particular attention should be paid to provisions regarding assessment obligations of both non-developer owners and the developer, voting rights, conditions for amending governing documents and developer's right to change or add facilities without the consent of the association (multi-site time-share developers often retain the right to add resorts and dwelling units to the project without the consent of the project's association. That is normally acceptable as long as the project's governing documents include adequate conditions for such addition including, but not limited to, completion, protection from blanket encumbrances, suitable access, completion of off-site improvements, etc.).

The developer may argue that the Department should accept non-complying provisions because the time-share project has been approved in other jurisdictions and has made significant sales in other states. This is not a valid argument if the reasonable arrangements statutes cited above are not observed in the project documents. If, however, certain non-complying provisions do not meet specific regulatory requirements, the Deputy may consider accepting those provisions if the there are other provisions or circumstances of the project that offer a reasonable alternative to the regulation that is not observed. If the Deputy is uncertain about the acceptability of any non-complying provisions, he or she should consult the Managing Deputy Commissioner.

Documents for Out-of-State Component Sites

Because out-of-state subdivision requirements do not often include subdivision requirements comparable to the Subdivision Map Act of California, and because the situs state may have limited regulations regarding such subdivisions, the Department may be the only regulatory agency with any subdivision review duties involving some component sites. See ***Subdivision Map Act*** earlier in this manual for a discussion on out-of-state subdivision maps.

There are out-of-state jurisdictions that do not have title systems similar to that of California. In those cases, preliminary title reports comparable to California's title report may not be available. Another form of title report may be submitted or an attorney's opinion of title may be provided. These "alternative" forms of assurance of title should be examined closely for validity and completeness. If an attorney's opinion of title is submitted, the document should not be accepted if the attorney is associated with the developer. If the Deputy is not certain of the validity or the substance of the title document it should be referred to the Legal Section for review.

If the component site is in a foreign country, the title document should be referred to the Legal Section for review. If the language of that country is not English, both the copies of the original documents for the subdivision and English translations of those documents should be provided. These documents might include governing documents and any other documents having to do with the subdivision. The title documents should be referred to the Legal Section for review. If the Deputy is satisfied as to the validity of the English translations, the Deputy may review the documents without the assistance of Legal counsel. If the Deputy has any questions regarding the validity or meaning of the documents, those questions should be referred to the Legal Section.

Escrow Requirements Regarding Inventory Control

The escrow depository for the sale of multi-site time-share project interests must be an acceptable California escrow company pursuant to Regulation 2791.4. The developer and escrow depository must submit a detailed written explanation of how interests will be sold and closed to prevent overselling. Because project interests are likely sold out-of-state, there must be adequate assurances for protections against overselling in all jurisdictions. It may be that, especially with respect to right-to-use interests, the sale of interests in all jurisdictions must be processed through the California escrow depository.

Mandatory Reservation Systems

If a single-site time-share project is affiliated by means of a contract or membership agreement through a mandatory reservation system with other time-share projects or resorts and time-share purchasers of interests in the single-site time-share project receive, on a priority basis, the use or occupancy of accommodations at that site, as defined in the Business and Professions Code Section 11003.5(h), the single-site time-share project is subject to all the regulatory requirements of any other single-site time-share project.

The reservation system documents that are established for the purpose of administering reservations among owners of interests for the component time-share projects or resorts affiliated through the contract or membership agreement are not subject to DRE regulation. However, there must be provisions in those documents for disaffiliation from the reservation system affiliation agreement and for limitation on costs assessed to time-share owners in the single-site time-share project as required by Business and Professions Code Section 11003.5(h)(2).

The Declaration for the single-site time-share project must include, pursuant to Regulation 2811(a)(24), a provision requiring a time period of not less than 3 months during which owners in the single-site time-share project may make a reservation prior to the time period in which other persons may make reservations at that site.

Because Business and Professions Code Section 11018.10 provides that the sale of an interest in a single-site time-share project coupled with a representation that a purchaser shall obtain a guaranteed right to use and occupy accommodations or facilities at more than one site shall be regulated as a multi-site time-share project, it is necessary by Regulation that a copy of all marketing materials used in the promoting the sale of time-share interests be submitted so it can be determined whether this representation is made.

The disclosure in the Public Report concerning this kind of project should be clear that there are no assurances regarding the ability to reserve accommodations in the component resorts and that there are no assurances that the mandatory reservation system will continue to exist.

EXCHANGE PROGRAMS

With the passage of Assembly Bill 2530 (AB2530) in 1996 the Department's jurisdiction over exchange programs was reduced to disclosure only. Included in AB2530 was the addition of Business and Profession Code Section 11003.5(d) which defines exchange programs, and the addition of Section 11018.8 that states exchange programs shall not be subject to regulation by the Department. Section 11018.8 also includes a list of exchange program information that time-share Public Report applicants must include with the Notice of Intention. Hence, the Department developed the following exchange program note to be included in Public Reports on all time-share projects that are affiliated with exchange programs:

"This time-share project may be affiliated with one or more exchange programs whereby time-share owners may voluntarily exchange the right to use and occupy accommodations and facilities in this project with accommodations in other projects. Exchange programs are not subject to Department of Real Estate laws and regulations. Therefore, the Department of Real Estate has not evaluated any exchange program(s) included in this offering. There is no guarantee that this project will remain affiliated with any particular exchange program. Since exchange programs are unregulated, the Department recommends prospective purchasers use discretion in evaluating exchange programs offered in conjunction with time-share offerings."

EXIT, SAMPLER, OR SHORT TERM PROGRAMS

Time-share sponsors may choose to offer to prospective purchasers, who do not initially purchase a time-share interest, an opportunity to purchase a short term right to use the time-share project with the understanding that all payments can be credited towards the future purchase of a time-share interval. These types of marketing programs are often referred to as ***exit programs***, ***sampler programs***, or ***short term programs***.

Since the sale of a short term right to use (less than 5 years) is not considered a sale if a time-share interest, sponsors often do not include information on the sale of short term programs with the Notice of Intention. However, if the sponsor represents the short term program payments can be credited towards the purchase of a time-share interval in the future, the short term product offering becomes a time-share offering subject to DRE jurisdiction. For this reason, the time-share Notice of Intention has been specifically written to question the offering of short term products with purchase money credits towards the purchase of a time-share interval.

Following are some of the compliance issues with which the Deputy should be concerned when reviewing short-term programs:

- Purchase money handling pursuant to Business and Professions Code Section 11013 and Regulation 2791.

- Title inventory pursuant to Business and Professions Code Section 11018(c).

- Adequate contractual writing to secure the sponsor's promise to the purchaser in compliance with Business and Professions Code Section 11018(b).

- Maintenance arrangements for the short term use products within the time-share project.

POINTS-BASED TIME-SHARE PROJECTS

Point systems are structures for flexible use whereby the value of the use right of a time-share interest owner is expressed in terms of points rather than in increments of time.

The product sold to a purchaser may consist of a time-share estate or time-share use not coupled with an estate in real property. The value of the reservation right is entirely a function of the number of points the purchaser receives at the time of purchase. The number of points conveyed to a purchaser are typically shown in the purchase agreement. Sometimes, they may be denoted in the Grant Deed, if the offering is an estate offering. Regardless of the number of points purchased, that number does not change unless the time-share owner purchases more points at a later time.

Point valuations for each unit-type, season or portion of the year, and each resort, if the offering is a multi-site time-share project, should be established in the recorded Declaration for the project. The

Deputy should inquire about how point values are calculated, the cost of each point, whether additional points may be purchased in the future and how those additional points may be purchased. The Deputy should be certain that the number of points to be offered for sale are consistent with the total number of points assigned by the developer to the property as shown in the Declaration. The Deputy should also ascertain whether the number of points assigned by the developer to each element of the offering (type of unit, time of year, resort, etc.) works logically in the context of the total offering.

The sponsor should disclose whether there is a minimum number of points the purchaser must purchase. The Deputy should determine through his or her evaluation of the time-share governing documents and conveyance documents that the purchaser is reasonably assured that his or her rights will not diminish over time. The time-share governing documents usually include provisions permitting the time-share operator to change point assignations to units, resorts, seasons of the year, etc. due to changes in demand. The Declaration should include the rules and procedures for such changes and those rules must be reasonable in conformance with Sections 11018.5(d) and (e) of the Business and Professions Code. The association must be the only party authorized to change point assignations. Current policy is that the Declaration prohibit point assignations more than 10% in any year without the vote of the non-Declarant members.

The sponsor should provide a complete and understandable statement concerning the inventory control method to prevent overselling. The statement must also explain how the inventory control procedures will work if sales are made out-of-state. Escrow procedures must be established with an independent escrow company or title company. The Deputy should require the submittal of a detailed statement from escrow agent also explaining its inventory control procedures.

INCIDENTAL BENEFITS

Incidental Benefits are defined in Section 11003.5(e) of the Business and Professions Code as an accommodation, product, service, discount, or other benefit, other than an exchange program, which is offered prior to the end of the rescission period, the continuing availability of which is limited to a term of 5 years or less.

Under Section 11018.9 of the Business and Professions Code, an Incidental Benefit is not part of the offering and is not regulated by the DRE if the following is true:

(1) The continued availability of an Incidental Benefit is not necessary in order for any accommodation or facility which is not an Incidental Benefit to be used, occupied or enjoyed by owners consistent with the time-share documents or represented by the sponsor in writing, in the Public Report, in any advertisement or promotion, or otherwise; and

(2) The use of the Incidental Benefit by a time-share owner is completely voluntary, and the payment of any fee or other cost associated with the Incidental Benefit is required only upon use or participation; and

(3) Costs of acquisition, operation, maintenance or repair of the Incidental Benefit is passed on to time-share owners as common expenses of the time-share project.

The time-share application (RE 668A) includes a section devoted to Incidental Benefits and the three conditions of an Incidental Benefit listed above. All of the three conditions must exist for the benefit to be considered an Incidental Benefit, in addition to that condition that the term of the benefit not exceed five years. If the sponsor indicates in the application that one or more these conditions do not exist, the benefit offered is not an Incidental Benefit. The Deputy should then evaluate the benefit as part of the

offering applying the provisions of Sections 11018, 11018.5(d) and (e) of the Business and Professions Code.

The sponsor is also asked, through the application, to describe each Incidental Benefit to be offered, and if there are any restrictions upon use or availability. If, based on the answers given in the application, and any supporting documents submitted with the application, all of the conditions do exist, the benefit is an Incidental Benefit and need not be considered further except that the Public Report will include a generic disclosure regarding the fact that the sponsor may offer incidental benefits. The Deputy has the option to include a description of the particular Incidental Benefit to be offered pursuant to Section 11018.9(d) of the Business and Professions Code.